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## State Judges As Guardians of Federalism: Resisting the Federal Arbitration Act's Encroachment on State Law

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# State Judges as Guardians of Federalism: Resisting the Federal Arbitration Act's Encroachment on State Law<sup>©</sup>

David S. Schwartz\*

## INTRODUCTION

Despite leading a “federalism revival,”<sup>1</sup> the U.S. Supreme Court has ignored the federalism problem inherent in its decisions nullifying state laws by holding them preempted. The most glaring example is the Court’s continuing adherence to its badly reasoned 1984 decision in *Southland Corp. v. Keating*,<sup>2</sup> which holds that the Federal Arbitration Act<sup>3</sup> (FAA) binds state courts and preempts state law. Although the Court has expressed its fundamental “‘belief in the importance of state control of state judicial procedure,’”<sup>4</sup> the *Southland* doctrine restructures state dispute-resolution processes for *state law claims*. And while the Court has stated that contracts are an area of traditional state regulation which federal courts should be “‘reluctant to federalize,’”<sup>5</sup> the *Southland* doctrine goes a long way

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1. The leading federalism decisions, which have limited congressional commerce power, strengthened state “sovereign immunity,” and revived the Tenth Amendment, are well known. See, e.g., Richard H. Fallon, Jr., *The “Conservative” Paths of the Rehnquist Court’s Federalism Decisions*, 69 U. CHI. L. REV. 429, 430 (2002).

2. 465 U.S. 1 (1984).

3. 9 U.S.C. §§ 1–16 (2000).

4. *Howlett v. Rose*, 496 U.S. 356, 372 (1990) (quoting Henry Hart, *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489, 508 (1954)); accord *Johnson v. Fankell*, 520 U.S. 911, 919 (1997); see also *Felder v. Casey*, 487 U.S. 131, 150 (1988).

5. *Patterson v. McLean Credit Union*, 491 U.S. 164, 183 (1989) (quoting *Santa Fe Indus. v. Green*, 430 U.S. 462, 479 (1977)).

towards entirely taking state courts and legislatures out of the business of making contract law.

Federalism is a battle often waged in the courts.<sup>6</sup> State judges have a special role in this battle, because, unlike their federal counterparts, they are sworn to uphold not one, but two constitutional systems. In this Article I argue that two principled tools of statutory interpretation designed to safeguard state autonomy in the name of federalism—the doctrine of constitutional avoidance and the presumption against preemption—have been ignored, and indeed violated, by the federal courts in FAA preemption cases. I argue further that it is incumbent on state court judges to use these tools pursuant to their dual constitutional duties, which authorize and require them (1) to interpret federal statutes independently in the absence of a controlling Supreme Court precedent; and (2) to give due regard to the interests of their states in the enforcement of state laws in the absence of a clear congressional mandate to preempt those laws. This requires state courts to construe both the FAA itself and the U.S. Supreme Court’s FAA preemption precedents as narrowly as good faith permits.

### I. *SOUTHLAND* AS A FEDERALISM DISASTER

The values of federalism, articulated in *Gregory v. Ashcroft*,<sup>7</sup> provide a basis for evaluating *Southland*’s federalism error:

This federalist structure of joint sovereigns preserves to the people numerous advantages. It assures a decentralized government that will be more sensitive to the diverse needs of a heterogeneous society; it increases opportunity for citizen involvement in democratic processes; it allows for more innovation and experimentation in government; and it makes

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6. This battle is well illustrated by the remarkably frank criticism by a state supreme court justice of some lower federal courts’ overly broad approach to FAA preemption in *Casarotto v. Lombardi*, 886 P.2d 931, 939–42 (Mont. 1994) (Trieweiler, J., specially concurring), *overruled by* *Doctor’s Assocs. v. Casarotto*, 517 U.S. 681 (1996).

7. 501 U.S. 452 (1991).

government more responsive by putting the States in competition for a mobile citizenry.<sup>8</sup>

Each of these values of federalism assumes a substantial degree of state lawmaking autonomy; none would have much meaning if the states were merely “regional offices [or] administrative agencies of the Federal Government.”<sup>9</sup>

Preemption doctrine represents the most significant and frequently applied limitation on substantive state autonomy in our constitutional scheme.<sup>10</sup> While federal commerce power still potentially reaches most subjects of legislation even after *United States v. Lopez*<sup>11</sup> and *United States v. Morrison*,<sup>12</sup> preemption doctrine holds that Congress may nullify state law on any subject within federal legislative jurisdiction. Therefore,

the true test of federalist principle may lie, not in the occasional effort to trim Congress’s commerce power at its edges . . . or to protect a State’s treasury from a private damage action . . . but rather in those many statutory cases where courts interpret the mass of technical detail that is the ordinary diet of the law

—namely, preemption cases.<sup>13</sup> FAA preemption under *Southland* tramples on these federalism values by nullifying and federalizing the dispute resolution processes and contract law of the states.

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8. *Gregory*, 501 U.S. at 458; *accord* *United States v. Lopez*, 514 U.S. 549, 552 (1995) (citing *Gregory* as setting forth the “first principles” of federalism); *id.* at 581 (Kennedy, J., concurring) (quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (arguing that states can serve as “laboratories for experimentation” in social policy)).

9. *New York v. United States*, 505 U.S. 144, 188 (1992).

10. See Stephen A. Gardbaum, *The Nature of Preemption*, 79 CORNELL L. REV. 767, 768 (1994).

11. 514 U.S. 549 (1995).

12. 529 U.S. 598 (2000).

13. *Egelhoff v. Egelhoff*, 532 U.S. 141, 160 (2001) (Breyer, J., dissenting).

### A. *The Southland Decision*

In *Southland Corp. v. Keating*,<sup>14</sup> several California 7-Eleven convenience store franchisees sued the corporate owner-franchisor of the 7-Eleven chain in state court under various state law theories, including a state franchise law designed to protect franchisees from overreaching.<sup>15</sup> Southland sought to compel arbitration of all claims pursuant to an arbitration clause in the form franchise agreement, but the California Supreme Court denied arbitration on the basis of a generic antiwaiver provision in the Franchise Investment Law which states that “[a]ny condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.”<sup>16</sup> The California court reasoned that the arbitration agreement operated as a waiver of the statutory right to a jury trial.<sup>17</sup> The U.S. Supreme Court reversed, holding that section 2 of the FAA preempted the state rule against arbitrating statutory franchise disputes. The *Southland* majority reasoned that Congress, by basing the FAA on its power “to enact substantive rules under the Commerce Clause,” must have intended to make “substantive” law binding on state as well as federal courts.<sup>18</sup> “In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.”<sup>19</sup>

Since *Southland*, the principle of FAA preemption has become firmly, if erroneously, established. The Supreme Court itself has reaffirmed or extended *Southland* in four cases, notwithstanding

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14. 465 U.S. 1 (1984).

15. California Franchise Investment Law, CAL. CORP. CODE § 31000 (West 2004); see also *Southland Corp. v. Keating*, 465 U.S. 1, 21 (1984) (Stevens, J., dissenting) (explaining purpose of the law).

16. CAL. CORP. CODE. § 31512 (West 2004) (emphasis added). This antiwaiver provision is modeled after an antiwaiver provision in section 14 of the Securities Act of 1933, 15 U.S.C. § 77n, which has long served as a model for the drafting of consumer-protection statutes of all kinds through the country. See *infra* Appendix B.

17. See *Southland*, 465 U.S. at 10 (citing CAL. CORP. CODE ANN. § 31512 (West 1977)).

18. *Id.* at 11–12.

19. *Id.* at 10.

serious doubts about its correctness.<sup>20</sup> *Southland* is a poorly reasoned decision on a number of grounds, as I have argued elsewhere.<sup>21</sup> Among its other failings, given the FAA's silence on the question of the statute's applicability in state court, and legislative history pointing strongly *against* a construction that the FAA preempts state law, the *Southland* preemption holding was a stretch and becomes increasingly difficult to justify in the ensuing federalism revival. For present purposes, I will focus on its impact on state law.

### B. *Southland's Current Effects on State Law*

Under *Southland*, the FAA has been construed to bind state courts and preempt state laws that target arbitration agreements for special barriers to enforcement, whereas "generally applicable contract defenses" and rules that "arose to govern . . . contracts generally" may be applied to arbitration agreements "without contravening

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20. *Doctor's Assocs. v. Casarotto*, 517 U.S. 681 (1996) (FAA section 2 preempts Montana statute imposing protective form requirements on arbitration agreements); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995) (FAA section 2 preempts Alabama statute barring enforcement of predispute arbitration agreements); *Perry v. Thomas*, 482 U.S. 483 (1987) (FAA section 2 preempts California statute barring enforcement of predispute arbitration agreements for wage and hour claims). In *Circuit City Stores v. Adams* 532 U.S. 105 (2001), the Court brushed aside an opportunity to employ the federalism-based presumption against preemption which would have allowed the Court to decline to extend *Southland* further. Two other cases stated that the FAA would preempt state laws that "would undermine the goals and policies of the FAA." *Volt Info. Sci. v. Stanford Univ.*, 489 U.S. 468, 477–78 (1989); see also *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 59 (1995) ("[I]n the absence of contractual intent to the contrary, the FAA would pre-empt" state decisional law precluding punitive damage award by arbitrator).

While no member of the *Southland* majority has been on the Court since 1994, five current members of the Court have at one time or another stated that *Southland* was wrongly decided. See *Southland*, 465 U.S. at 18–21 (Stevens, J., concurring in part and dissenting in part) (dissenting from proposition that FAA section 2 preempts state statutes, as opposed to common-law rules, limiting enforceability of arbitration agreements for certain types of cases); 465 U.S. at 24 (O'Connor, J., joined by Rehnquist, J., dissenting) (*Southland* majority wrongly concluded that FAA section 2 created federal substantive rights that must be enforced in state courts); *Allied-Bruce*, 513 U.S. at 283–84 (O'Connor, J., concurring) (same); *id.* at 284–85 (Scalia, J., dissenting) ("Adhering to *Southland* entails a permanent, unauthorized eviction of state-court power to adjudicate a potentially large class of disputes."); *id.* at 285 (Thomas, J., joined by Scalia, J., dissenting) ("In my view, the Federal Arbitration Act does not apply in state courts.").

21. See David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67 LAW & CONTEMP. PROBS. (forthcoming 2004) [hereinafter Schwartz, *Statutory Interpretation*].

[FAA] § 2.”<sup>22</sup> The FAA thus preempts only those state laws that regulate arbitration agreements *per se*<sup>23</sup> or that declare certain types of substantive claims non-arbitrable.<sup>24</sup>

Even with these limitations, scores of state laws have been held preempted or have become subject to FAA preemption under *Southland*. In the past two-and-one-half years alone, at least fifty different state laws have been held preempted by the FAA.<sup>25</sup> At least thirty states have one or more statutes containing antiwaiver provisions of the kind held preempted in *Southland*.<sup>26</sup> Many states have tried to regulate arbitration agreements by creating specific exceptions to a general state rule of specific enforcement of arbitration agreements, but *Southland* preempts these laws.<sup>27</sup>

A key, and frequently celebrated value of federalism, is that it enables states to serve as “laboratories for experimentation” in social policy.<sup>28</sup> But preemption stifles state law “experimentation” not only by nullifying state laws on the books, but also by discouraging proposals to change the law. For example, the National Conference of Commissioners on Uniform State Laws was considering addressing issues relating to adhesive arbitration agreements in its Revised Uniform Arbitration Act, but determined that “the preemptive effect of the Federal Arbitration Act . . . dramatically limits meaningful choices for drafters addressing adhesion contracts . . . .”<sup>29</sup>

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22. *Doctor's Assocs.*, 517 U.S. at 686–87 (quoting *Perry*, 482 U.S. at 492 n.9); accord *Allied-Bruce*.

23. See *Doctor's Assocs.*, 517 U.S. at 687 (nullifying Montana law require certain formalities for all arbitration agreements); *Allied-Bruce*, 513 U.S. at 281 (nullifying Alabama law making predispute arbitration agreements *per se* invalid).

24. See *Southland*, 465 U.S. at 12 (nullifying California law making arbitration agreements invalid for claims under franchise statute); *Perry*, 482 U.S. at 491 (same for statutory wage claims).

25. See *infra* Appendix A.

26. See *infra* Appendix B.

27. See Schwartz, *Statutory Interpretation*, *supra* note 21.

28. See *United States v. Lopez*, 514 U.S. 549, 581 (Kennedy, J., concurring) (citing *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)).

29. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAW, ADHESION ARBITRATION AGREEMENTS AND THE RUAA, available at <http://www.law.upenn.edu/blj/ulc/uarba/arbr0500.htm> (last modified Aug. 23, 2000).

### *C. The FAA and Federalism-Based Statutory Interpretation Principles*

#### 1. *Southland*'s Dubious Constitutionality and the Constitutional Avoidance Doctrine

A long-established principle of judicial restraint, the doctrine of constitutional avoidance holds that “if a case can be decided on either of two grounds, one involving a constitutional question, the other a question of statutory construction or general law, the Court will decide only the latter.”<sup>30</sup> As a corollary principle, “where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.”<sup>31</sup> The Court has failed to apply these principles in the *Southland* line of cases.

The FAA is a statute that, at bottom, governs *procedure*. The choice of arbitration over litigation simply “trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition” of arbitral procedures.<sup>32</sup> The Supreme Court has repeatedly emphasized the fundamentally “procedural”<sup>33</sup> nature of arbitration agreements: arbitration agreements are “in effect, a specialized kind of forum selection clause,”<sup>34</sup> in which a

30. *Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring).

31. *Solid Waste Agency of N. Cook County v. Army Corps of Eng'rs*, 531 U.S. 159, 173 (2001) (internal quotations omitted). In *Solid Waste Agency*, a federal agency interpreted the Clean Water Act in a manner which raised a federalism-based constitutional question by “invok[ing] the outer limits of Congress’s power . . . .” *Id.* at 172. The Court gave a narrowing construction to the statute to avoid the constitutional issue. *Id.* at 173–74.

32. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991) (internal quotations omitted).

33. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 481–82 (1989) (overruling determination in *Wilko v. Swan*, 346 U.S. 427 (1953) (arbitration affects substantive rights)).

34. *Rodriguez*, 490 U.S. at 482–83 (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 (1974)); *accord* *EEOC v. Waffle House*, 534 U.S. 279, 295 (2002) (arbitration agreement is “effectively a forum selection clause”); *Circuit City Stores v. Adams*, 532 U.S. 105, 123 (2001) (“by agreeing to arbitrate . . . a party does not forego . . . substantive rights”); *Gilmer*, 500 U.S. at 26 (same); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) (same).



party compelled to arbitrate “does not forgo . . . substantive rights,” but “only submits to their resolution in an arbitral, rather than a judicial, forum.”<sup>35</sup> Thus, by holding that the FAA binds state courts, the *Southland* doctrine permits a federal restructuring of state dispute resolution procedures by supplanting such processes as a jury trial, discovery and plenary appellate review. That the mechanism for this restructuring under the FAA relies on the mediating device of a private contract term does not in any way lessen the federal intrusion on state dispute-resolution processes. The effect of *Southland* in cases involving no federal question, therefore, is to restructure state dispute resolution processes for *state law claims*.<sup>36</sup> Cases in which a state would open its courts to litigants are compelled into arbitration under *Southland*, irrespective of the presence of a substantive federal interest—that is, a federal interest other than an interest in the dispute resolution process itself.

The traditional means for Congress to guarantee certain procedures for federal claims is not to dictate procedure to state courts, but to create federal question jurisdiction to open the doors of the federal courthouse to the claim.<sup>37</sup> The authority of Congress to restructure state dispute resolution procedures has been found to exist only in a handful of exceptional cases where a state procedure directly impairs a substantive federal claim or defense.<sup>38</sup> Does the commerce power authorize Congress to restructure state dispute

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35. *E.g.*, *Mitsubishi*, 473 U.S. at 628.

36. *See* *Allied-Bruce Terminix Cos. v. Dobson* (1995), 513 U.S. 265, 284–85 (Scalia, J., dissenting) (*Southland* “entails a permanent, unauthorized eviction of state-court power to adjudicate a potentially large class of disputes.”).

37. To the extent there is a federal interest in protecting arbitration for federal claims filed initially in state court, that interest is adequately protected, even without *Southland* preemption, by removal jurisdiction. *See* 28 U.S.C. § 1441 (2000 & Supp. II 2003).

38. Just as state courts may not discriminate against federal rights in exercising jurisdiction, *see* *Testa v. Katt*, 330 U.S. 386 (1947), so they may not uniquely disadvantage or discriminate against federal “rights of recovery” by imposing particular procedural obstacles. *See* *Howlett v. Rose*, 496 U.S. 356 (1990) (state municipal immunity doctrine against § 1983 claims in state court held preempted); *Felder v. Casey*, 487 U.S. 131 (1988) (application of state notice-of-claim statute for § 1983 claims in state court held preempted). However, in the absence of such discrimination, “federal law takes the state courts as it finds them.” *Howlett*, 496 U.S. at 372. Thus, it is doubtful whether any federal power to control neutral state procedures in federal question cases exists at all. *See* *Johnson v. Fankell*, 520 U.S. 911, 922–23 (1997) (neutral state rule denying interlocutory appeals not preempted by federal rule allowing such appeals for § 1983 defendants).

resolution processes for *state law* claims, even under the guise of “substantive” regulation of interstate contracts?

The constitutionality of such a power is doubtful at best.<sup>39</sup> In *Johnson v. Fankell*, the Supreme Court “made it quite clear that it is a matter for each State to decide how to structure its judicial system.”<sup>40</sup> The *Johnson* Court was unanimous in observing that “respect [for federalism] is at its apex when we confront a claim that federal law requires a State to undertake something as fundamental as restructuring the operation of its courts.”<sup>41</sup>

When Congress displaces state dispute resolution procedures, in whole or in part, by creating exclusive jurisdiction in federal district courts or federal administrative tribunals,<sup>42</sup> it does so by asserting plenary *substantive* authority over a particular subject matter, and at least implicitly identifying a strong federal interest in that subject matter.<sup>43</sup> Thus, for example, collective bargaining agreements, although private contracts in form, have long been regarded as contracts carrying national public policy implications, due to the history of labor strife.<sup>44</sup>

What exactly is the federal interest in restructuring state dispute resolution procedures for state law claims? The FAA, in contrast to federal labor law, evinces a congressional intent to bring private contractual arbitration agreements into general contract law, not lift

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39. See *A Review of the Global Tobacco Settlement: Hearing Before the Senate Comm. on the Judiciary*, 105th Cong. 160 (1997) (statement of Laurence H. Tribe) (“For Congress directly to regulate the procedures used by state courts in adjudicating state-law tort claims—to forbid them, for example, from applying their generally applicable class action procedures in cases involving tobacco suits—would raise serious questions under the Tenth Amendment and principles of federalism.”); Anthony J. Bellia, Jr., *Federal Regulation of State Court Procedures*, 110 YALE L. J. 947 (2001) (Congress lacks constitutional authority to regulate state procedures for state law claims); Wendy E. Parmet, *Stealth Preemption: The Proposed Federalization of State Court Procedures*, 44 VILL. L. REV. 1, 42–52 (1999) (same).

40. 520 U.S. at 922 n.13.

41. *Id.* at 922.

42. See, e.g., Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (2000) (original jurisdiction placed exclusively in federal district courts); National Labor Relations Act §§ 3, 10, 29 U.S.C. §§ 153, 160 (2000) (original jurisdiction placed exclusively in federal administrative agency).

43. See National Labor Relations Act § 1, 29 U.S.C. § 151 (2000) (identifying federal interests).

44. See *United Steelworkers of Am. v. Am. Mfg. Co.*, 363 U.S. 564, 567–68 (1960); *United Steelworkers of Am. v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 577–78 (1960).

them out of it into a category of special federal concern. Not only has Congress failed, in the FAA or otherwise, to identify alternative dispute resolution as a matter of pressing national concern that must be imposed on all levels of government, but one searches the FAA in vain for any substantive federal policy that might be at stake in such matters as whether a state will keep its courthouse doors open to state law wage and hour claims. Although the FAA identifies a federal nexus—contracts involving interstate commerce or admiralty—the Supreme Court has never found in the FAA an intent to assert plenary substantive authority over all such contracts, even those interstate commerce contracts containing arbitration agreements. The absence of substantive federal policy underlying the FAA explains why the FAA *does not even create federal question jurisdiction*. It has become commonplace to answer the “federal interest” question by waving the flag of the so-called “national policy favoring arbitration,”<sup>45</sup> but that is nothing more than a circular argument that fails to explain why Congress would, or constitutionally could, impose such a policy on the states.

By holding that the FAA binds state courts and preempts state law, *Southland* thus violates the principle of constitutional avoidance, adopting a construction of the FAA that raises serious constitutional doubts when an alternative construction is highly plausible, and consistent with the intent of Congress.

## 2. The Clear Statement Rule and the Presumption Against Preemption

In a closely related doctrinal development, in *Gregory v. Ashcroft*,<sup>46</sup> the Supreme Court established a rule of statutory interpretation designed to protect state autonomy against federal encroachment: “If Congress intends to alter the usual constitutional balance between the States and the Federal Government, it must make its intention unmistakably clear in the language of the statute.”<sup>47</sup> A subset of this federalism-based “clear statement” rule is

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45. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

46. 501 U.S. 452 (1991).

47. *Id.* at 460 (internal quotations omitted).

the long-established presumption against preemption: “‘where . . . the field which Congress is said to have preempted includes areas that have been traditionally occupied by the States,’ congressional intent to supersede state laws must be ‘clear and manifest.’”<sup>48</sup>

One of the major failings of the *Southland* preemption doctrine is its total disregard for these principles. The FAA includes no “clear statement” of congressional intent to preempt state law, or to intrude heavily on the states’ traditional control over general contract law. It is widely recognized that the “national policy favoring arbitration” was not the creation of the FAA as written by Congress, but was instead a judicial creation—federal common law—that took the FAA as a point of departure.<sup>49</sup> As clearly demonstrated in two scholarly dissenting opinions from the Supreme Court, the *Southland* opinion flouted the FAA’s historical record, which showed that Congress intended the FAA to be a procedural statute that neither applied in state court nor preempted state law.<sup>50</sup> Even the *Southland* majority opinion conceded the absence of anything that would meet the “clear statement” test, by going outside the FAA’s text to rely on a legislative history that was “not without ambiguities.”<sup>51</sup>

## II. THE ROLE OF STATE JUDGES IN FAA PREEMPTION CASES

State judges have a unique role in our constitutional system. They alone are assigned the delicate task of applying the law of multiple sovereigns (the law of their own states, of their sister states, and of

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48. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 283 (1995) (O’Connor, J., concurring) (quoting *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990)). “To the extent that federal statutes are ambiguous, we do not read them to displace state law.” *Allied-Bruce*, 513 U.S. at 292 (Thomas, J., dissenting); *accord Southland*, 465 U.S. at 18 (Stevens, J., concurring in part and dissenting in part) (“The exercise of state authority in a field traditionally occupied by state law will not be deemed pre-empted by a federal statute unless that was the clear and manifest purpose of Congress.”).

49. See, e.g., *Allied-Bruce*, 513 U.S. at 283 (O’Connor, J., concurring) (“[T]he Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation.”).

50. See *Southland*, 465 U.S. at 23–31 (O’Connor, J., dissenting); *Allied-Bruce*, 513 U.S. at 285–95 (Thomas, J., dissenting). For additional historical evidence supporting the arguments in the O’Connor and Thomas dissents, see Schwartz, *Statutory Interpretation*, *supra* note 21, at 19–31.

51. 465 U.S. at 12.

the federal government) *while bound by oath to uphold not one, but two constitutions*, federal and state. At the same time, the U.S. constitutional system of checks and balances—both in its “horizontal” separation of powers, and its “vertical” structure of federal and state sovereignty—is designed so that a proper system-wide balance will emerge if each constitutional participant acts attentively toward its own institutional interests.<sup>52</sup> In this system, it is incumbent on state judges to remain particularly attentive to the balance between state autonomy and federal supremacy.

Under the Supremacy Clause, state judges are obligated to apply federal law.<sup>53</sup> But this obligation carries a concomitant power to interpret federal law independently. “[S]tate courts . . . possess the authority, absent a provision for exclusive federal jurisdiction, to render binding judicial decisions that rest on their own interpretations of federal law.”<sup>54</sup> While bound to follow an authoritative construction of a federal statute by the U.S. Supreme Court, state courts are not bound by lower federal court decisions.<sup>55</sup>

Preemption cases bring the sometimes competing duties of state judges to the forefront. Viewing preemption cases merely as issues of statutory interpretation overlooks the crucial constitutional dimension to preemption. Preempting a state law is not merely “applying” an act

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52. See, e.g., THE FEDERALIST NO. 28 at 180–81 (Alexander Hamilton) (Clinton Rossiter ed., 1961) (“Power being almost always the rival of power, the general government will at all times stand ready to check the usurpations of the state governments, and these will have the same disposition towards the general government.”); THE FEDERALIST NO. 51 at 323 (James Madison) (“The [federal and state] governments will control each other, at the same time that each will be controlled by itself.”).

53. U.S. CONST. art. VI, cl. 2 (“[T]he Judges in every State shall be bound” by federal law “made in Pursuance” of the Constitution); *Printz v. United States*, 521 U.S. 898, 908 (1997); *Testa v. Katt*, 330 U.S. 386 (1947).

54. *ASARCO, Inc. v. Kadish*, 490 U.S. 605, 617 (1989).

55. “This court is in any event under no obligation to follow federal lower court precedents interpreting acts of Congress when we find those precedents unpersuasive.” *Graham v. Scissor Tail, Inc.*, 623 P.2d 165, 179 (Cal. 1981); *accord Lockhart v. Fretwell*, 506 U.S. 364, 376 (1993) (Thomas, J., concurring); *Bodzai v. Arctic Fjord, Inc.*, 990 P.2d 616, 619 (Alaska 1999); *Brotman v. E. Lake Creek Ranch, L.L.P.*, 31 P.3d 886, 894 (Colo. 2001); *State v. Dwyer*, 332 So. 2d 333, 335 (Fla. 1976); *Flanagan v. Prudential-Bache Sec., Inc.*, 495 N.E.2d 345, 348 (N.Y. 1986); *Kornman v. Blue Cross/Blue Shield*, 662 So. 2d 498, 501 (La. Ct. App. 1995); *Northpointe Plaza v. City of Rochester*, 457 N.W.2d 398, 403 (Minn. Ct. App. 1990), *aff’d*, 465 N.W.2d 686 (Minn. 1991); *Kiefer v. Cont’l Airlines*, 882 S.W.2d 496, 502 (Tex. App. 1994).

of Congress, but involves two analytical steps: first, that the federal statute is intended to displace the state law or conflicts with it, and second, that the Supremacy Clause requires that the state law must give way to the federal statute. *Southland* was correct on this one point: a preempted state law “violates the Supremacy Clause” and is in that sense unconstitutional.<sup>56</sup>

Preemption cases are highly significant for judges concerned about the issues of “judicial activism” and “judicial restraint.” Where the state law is statutory, to preempt it is to override the will of the democratically elected state legislature. If Congress has expressed a clear statement to the effect that state law is preempted, the preemption decision represents the decision of the national legislature to exercise its supremacy over the state legislature. But what if Congress has not made such a clear statement? Where preemption results from a freewheeling judicial gloss on a silent statute, the override of state law is no less an instance of “judicial activism” than the creation of a new constitutional right under the due process clause. But more than that, it is judicial activism in disregard for federalism values.

FAA preemption should be viewed with particular caution by state judges because of its intrusion into state court procedures.

When pre-emption of state law is at issue, we must respect the principles [that] are fundamental to a system of federalism in which the state courts share responsibility for the application and enforcement of federal law. This respect is at its apex when we confront a claim that federal law requires a State to undertake something as fundamental as restructuring the operation of its courts.<sup>57</sup>

The FAA says nothing about preemption, and even the *Southland* majority admitted that the legislative history was at best ambiguous

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56. *Southland*, 465 U.S. at 16; see also Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 IND. L.J. 393, 397–98 (2004).

57. *Johnson v. Fankell*, 520 U.S. 911, 922 (1997) (internal quotations and citations omitted); accord *Howlett v. Rose*, 496 U.S. 356, 372–73 (1990) (states’ “great latitude to establish the structure and jurisdiction of their own courts . . . fundamental to a system of federalism in which the state courts share responsibility for the application and enforcement of federal law”).

on the intent to preempt. To be sure, the U.S. Supreme Court has decided that the FAA preempts certain state laws, and those rulings bind state judges under the Supremacy Clause. But in many specific cases, the answer to the preemption question is unclear; litigants may be pressing to expand FAA preemption into new applications. State judges who believe in “judicial restraint” and deference to the will of their state legislatures should be extremely hesitant to expand FAA preemption, and hesitant even to apply FAA preemption in close cases. U.S. Supreme Court decisions asserting FAA preemption can be applied faithfully, but narrowly. The state judge’s role under the state constitution is consistent with a rigorous application of the presumption against preemption and doctrine of constitutional avoidance.

### III. A FEDERALISM-BASED, “STRICT CONSTRUCTIONIST” APPROACH TO FAA PREEMPTION

FAA preemption questions are all fundamentally about whether state law can affect the enforceability of arbitration agreements. Although these enforceability questions take a variety of forms, they all fall into either of two broad categories. First, “contract defenses” involve either “formation questions”—whether an agreement to arbitrate was made at all—or “validity” questions, which consider whether the arbitration agreement can be held unenforceable because unfair terms make it either unconscionable or void as against public policy. Second, “arbitrability” issues concern legal rules holding that a particular type of claim or remedy is unsuitable for arbitration. Some recurring topics raise both “contract defense” and “arbitrability” questions, but do so in a way that is analytically separable. For example, an arbitration agreement written by a company to prevent any consumer from bringing a class action against it may be held invalid on unconscionability grounds. But the issue of whether an arbitrator can issue class-wide relief is an arbitrability question.

In this part, I argue that the federalism principles of constitutional avoidance and the presumption against preemption should guide courts—particularly state courts—in the resolution of both contract defense and arbitrability questions.

*A. Contract Defenses: Formation, Unconscionability and Public Policy*

Properly understood, contract defense questions can—and should—always be analyzed as matters of state law, and should never be preempted by the FAA, so long as the state contract law in question does not expressly target arbitration agreements. This is made clear by FAA section 2 which “saves” all “grounds for the revocation of any contract,” as subsequently explained by the Supreme Court in *Perry v. Thomas*,<sup>58</sup> *Allied-Bruce Terminix Cos.*,<sup>59</sup> and *Doctor’s Associates v. Casarotto*.<sup>60</sup> The unconscionability doctrine and the doctrine of voidness as against public policy are two doctrines of general contract law that can be applied to arbitration agreements under FAA section 2. FAA preemption of these doctrines should be rejected under the federalism principles described above. The following are specific recurring examples of issues that should routinely be resolved as validity questions controlled by state law.

1. Remedy-Stripping Provisions

Many arbitration agreements join the arbitration requirement with the limitation that the arbitrator cannot award various remedies, such as non-economic damages, attorneys’ fees and, particularly, punitive damages. Similarly, a growing number of arbitration agreements, particularly in consumer contracts, attempt to bar class actions.<sup>61</sup> Such clauses should never be “enforced as written.”<sup>62</sup> The Supreme Court has itself made clear that the doctrine of enforcing adhesive pre-dispute arbitration agreements presumes that “[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute.”<sup>63</sup> For present purposes, the key point

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58. 482 U.S. 483 (1987).

59. 513 U.S. 265 (1995).

60. 517 U.S. 681 (1996).

61. A contractual class action bar is plainly a remedy stripping clause, since small, individual consumer claims may only be viable as class actions. See David S. Schwartz, *Understanding Remedy-Stripping Arbitration Clauses: Validity, Arbitrability and Preclusion Principles*, 38 U.S.F. L. REV. 49 (2003) [hereinafter Schwartz, *Remedy-Stripping*].

62. *Id.*

63. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991); *Mitsubishi Motors*



is that the grounds for invalidating such agreements are purely state law principles. Courts properly consider damages remedies—including punitive damages—to be “important substantive right[s].”<sup>64</sup> Contractual attempts to force an adhering party to waive such rights in advance are routinely held to be invalid under the general state law principle of unconscionability.<sup>65</sup> Alternatively, such prospective waivers should be deemed void as against public policy.<sup>66</sup>

## 2. Unfair Arbitration Procedures

The specific arbitration procedure spelled out in the contract may, if it is sufficiently unfair, provide another basis to question the validity of an arbitration agreement. While “generalized attacks” on the adequacy of arbitration procedures are not a basis to invalidate a pre-dispute arbitration clause, claims of procedural inadequacy of arbitration under the terms of a specific arbitration agreement may be “resolv[ed] in specific cases.”<sup>67</sup> Procedural overreaching has been held in some cases to create “a sham system unworthy even of the name of arbitration.”<sup>68</sup> Again, the key point is that such contractual unfairness is simply an instance of unconscionability doctrine, and therefore a matter of state law.<sup>69</sup>

## 3. Imposition of Burdensome Arbitration Fees

The question of who will bear the forum fees of arbitration pursuant to pre-dispute adhesion contracts has emerged as an important issue in the last few years. Whereas access fees to a judicial forum are limited to the initial filing fee and possibly jury fees, these pale in comparison to the filing and administrative charges

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Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985).

64. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 63 (1995) (the right to punitive damages “is an important substantive right.”).

65. *See, e.g., Armendariz v. Found. Health Psychcare Servs.*, 6 P.3d 669 (Cal. 2000); *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (Cal. Ct. App. 1997).

66. *See* CAL. CIV. CODE § 1668 (West 2004); RESTATEMENT (SECOND) OF CONTRACTS § 195 (1979).

67. *Gilmer*, 500 U.S. at 33.

68. *Hooters of America, Inc. v. Phillips*, 173 F.3d 933, 940 (4th Cir. 1999).

69. *See, e.g., Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 179 (Cal. 1981).

and arbitrator fees in an arbitration, which can amount to thousands, or even tens of thousands, of dollars.<sup>70</sup> Moreover, if the plaintiff lost, he or she could be assessed that entire amount by the arbitrator. In the absence of a contractual allocation, traditional arbitration practice supplies a “default rule” under which each party pays half the arbitrators’ fees unless the arbitrators, in their discretion, order the losing party to pay all the fees. Thus, where the arbitration agreement does not mention the allocation of arbitrator fees, it is assumed they will be assessed, at least in part, against the employee.<sup>71</sup>

A number of courts have taken exception to the idea that a plaintiff could be forced, in essence, to pay thousands of dollars to the adjudicator to resolve important rights against the drafter of an adhesive employment or consumer contract. These courts have imposed a blanket rule against enforcing such agreements.<sup>72</sup> The U.S. Supreme Court, in *Green Tree Financial Corp.-Alabama v. Randolph*,<sup>73</sup> recognized that prohibitive arbitration fees might run afoul of the principle that arbitration agreements cannot force an employee to “forgo the substantive rights afforded by the statute,” but nevertheless rejected a blanket prohibition against express or implied “fee-sharing” arbitration agreements. Instead, *Randolph* held that the plaintiff had failed to make an individualized showing that the fees were prohibitive or deterred *her* from pursuing her statutory claims under the federal Truth in Lending Act.<sup>74</sup>

*Randolph* is best understood as a limited decision about arbitrability of Truth in Lending Act claims in particular, or possibly

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70. For example, a four-day arbitration of a small-to-moderate employment discrimination case before the American Arbitration Association claiming compensatory and punitive damages of, for example, \$200,000, would cost about \$12,000. See David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 44 n.30 (assuming an arbitrator’s hourly rate of \$350 per hour); AAA, National Rules for the Resolution of Employment Disputes (Jan. 2001), [www.adr.org](http://www.adr.org).

71. See, e.g., IAN R. MACNEIL ET AL., *FEDERAL ARBITRATION LAW* § 31.2.4, at pp. 31.12–13 (1999).

72. See *Armendariz v. Found. Health Psychcare Servs.*, 6 P.3d 669 (Cal. 2000); *Shankle v. B-G Maint. Mgmt. of Colorado*, 163 F.3d 1230, 1234–35 (10th Cir. 1999); *Paladino v. Avnet Computer Techs., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998) (Cox, J., concurring); *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465, 1468, 1484 (D.C. Cir. 1997).

73. 531 U.S. 79 (2000).

74. *Id.* at 91.

federal statutory claims more broadly. But it is not a decision that binds state courts on determinations of state unconscionability principles, under which the arbitration forum-fee issue should normally be decided. To construe *Randolph* as binding on state courts would be to treat it as creating a federal common law of unconscionability—that a finding of unconscionability will not be made on the basis of a cost claim without the specific proof—arguably preempting state law on the subject. Such a construction of *Randolph* would fly in the face of the presumption against preemption, and should therefore be rejected.

#### 4. Venue Provisions

Many arbitration agreements now appear bundled with venue clauses, requiring that the arbitration takes place in a distant state that maximizes convenience of the drafting party while discouraging the plaintiff from pursuing her claims.<sup>75</sup> To the extent that the FAA protects a contractual forum choice, it is the choice of arbitration over litigation; the FAA expresses no preference about *where* the arbitration take place. The enforceability of a venue provision in an arbitration agreement is thus a separate question not governed by the FAA. Many states have statutes prohibiting out-of-state venue provisions in certain kinds of contracts, as well as statutory or common law policies disfavoring oppressive venue clauses in contracts.<sup>76</sup> These state policies are analytically separate from the question of arbitration per se, and are therefore not preempted by the FAA.

#### 5. Mutuality and Contract Formation

Numerous courts have applied state contract principles to deny enforcement of arbitration agreements on a variety of contract

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75. See, e.g., *Bradley v. Harris Research*, 275 F.3d 884 (9th Cir. 2001) (contract requiring California franchisee to arbitrate in Utah); *In re Mgmt. Recruiters Int'l, Inc. and Nebel*, 765 F. Supp. 419 (N.D. Ohio 1991) (contract requiring California employee to arbitrate in Ohio).

76. See, e.g., CAL. BUS. & PROF. CODE § 20040.5 (West 2004) (prohibiting out-of-state forum selection clause in franchise agreements); CONN. GEN. STAT. §§ 42-133f(f), -133g(a) (2000) (same); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (1971).

formation issues. Where the agreement requires the adhering party, but not the drafter, to arbitrate claims, courts have analyzed these kinds of agreements as reflecting an absence of mutuality of obligation, and therefore conclude either that there is no agreement at all, or that the term is one-sided and unconscionable.<sup>77</sup> The FAA requires a “written agreement” to arbitrate as a prerequisite to an order compelling arbitration.<sup>78</sup> Courts are divided on the issue of whether notices or other un-executed writings purporting to make unilateral contract modifications—such as employee handbooks or “bill stuffers”—can create a binding arbitration agreement.<sup>79</sup> However a court resolves the issue, it is plainly one of state law of contract formation, and not purported “federal common law” under the FAA.<sup>80</sup>

### *B. Arbitrability: Is the Claim or Remedy Unsuitable for Arbitration?*

Arbitrability would seem to be a matter of state contract law under the principle that “arbitration is a matter of contract between the

77. See, e.g., *Showmethemoney Check Cashers, Inc. v. Williams*, 27 S.W.3d 361 (Ark. 2000) (refusing to enforce arbitration clause in “payday loan” contract that required the borrower to submit her claims to arbitration, but allowed the lender to pursue a collection action in court, due to “lack of mutuality”); *Armendariz v. Found. Health Psychcare Servs.*, 6 P.3d at 697; *Arnold v. United Cos. Lending Corp.*, 511 S.E.2d 854, 861 (W. Va. 1998); *Floss v. Ryan’s Family Steak Houses, Inc.*, 211 F.3d 306 (6th Cir. 2000) (applying state contract principles of “illusory” promises to deny enforcement to arbitration agreement requiring the employee to arbitrate his claims before a private arbitration company that specifically reserved the right to modify the rules and procedures of the arbitration without notice to or consent from the employee); *Gibson v. Neighborhood Health Clinics, Inc.*, 121 F.3d 1126 (7th Cir. 1997) (applying state contract principles to hold non-mutual arbitration agreement unenforceable because unsupported by consideration).

78. Federal Arbitration Act, 9 U.S.C. § 1 (2000).

79. Compare *Badie v. Bank of America*, 79 Cal. Rptr. 2d 779 (Cal. Ct. App. 1998) (credit card “bill-stuffer” containing arbitration agreement failed to demonstrate that “the parties intended to contract” about ADR), and *Heurtebise v. Reliable Bus. Computers*, 550 N.W.2d 243 (Mich. 1996) (provision in employee handbook disclaiming the creation of contractual rights vitiated the “agreement” element of the handbook’s arbitration provision), with *Patterson v. Tenet Healthcare, Inc.*, 113 F.3d 832 (8th Cir. 1997) (handbook did establish binding arbitration agreement).

80. See *First Options of Chicago v. Kaplan*, 514 U.S. 938, 943 (1995) (contract formation questions pertaining to arbitration agreements are “generally” resolved under state law); *Doctor’s Assocs. v. Casarotto*, 517 U.S. 681, 686–87 (1996) (“[S]tate law may be applied if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.”) (internal quotations omitted).

parties; it is a way to resolve those disputes—but only those disputes—that the parties have agreed to submit to arbitration.”<sup>81</sup> Arbitrability questions may have been needlessly complicated by overheated dicta in an early arbitration decision that spoke of the creation of “a federal [judge-made] substantive law of arbitrability,” under which “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.”<sup>82</sup> The Court has properly retreated from the implication that state law would be entirely displaced in construing arbitration agreements—an extreme position that flies in the face of the section 2 savings clause. In *First Options of Chicago v. Kaplan*, the Supreme Court held that courts “generally” should apply the state law of contract formation to determine what the parties agreed to arbitrate.<sup>83</sup> The presumption in favor of applying state law to arbitrability questions is strengthened by the presumption against preemption. The following two arbitrability issues are prominent in current cases.

### 1. Individual Claims and Remedies

In two recent cases, the California Supreme Court decided that statutory “public policy” claims could not be compelled into arbitration. In *Broughton v. Cigna Healthplans of California*,<sup>84</sup> the court held that claims for injunctive relief under the state Consumer Legal Remedies Act, designed to protect the public from deceptive business practices, were not subject to arbitration. In *Cruz v. PacifiCare Health Systems*,<sup>85</sup> the court extended that holding to preserve claims to enjoin unfair competition and misleading

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81. *First Options of Chicago*, 514 U.S. at 943.

82. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24, 25 & n.32 (1983).

83. 514 U.S. at 944–45. To be sure, a certain contradictory quality remains. The Court went on to qualify that general rule by establishing two specific federal common law presumptions: ambiguity over whether the parties agreed to arbitrate a dispute on the merits would be resolved in favor of arbitration; whereas ambiguity over whether the parties agreed to arbitrate “arbitrability”—whether a court or the arbitrator gets to decide who decides the merits—should be resolved in favor of leaving that issue to the court. *Id.* How a court should resolve the dispute over whether a court or arbitrator decides, however, is presumably left to state law.

84. 988 P.2d 67 (Cal. 1999).

85. 66 P.3d 1157 (Cal. 2003).

advertising under the state Business and Professions Code. According to the *Broughton* and *Cruz* courts, such claims were unsuitable for arbitration because (1) these statutory injunction claims were “for the benefit of the general public rather than the party bringing the action,” and (2) courts have “significant institutional advantages over arbitration in administering a public injunctive remedy, which as a consequence will likely lead to the diminution or frustration of the public benefit if the remedy is entrusted to arbitrators.”<sup>86</sup> For these reasons, the court concluded that there was an inherent conflict between arbitration and the statutory remedies, which gave rise to the inference that the state legislature intended to withhold such public injunction claims from arbitration.

*Cruz* and *Broughton* raise the question: how can a state legislature decide to withhold a public injunction claim from arbitration when *Southland* and *Perry v. Thomas* hold that the FAA “withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration”?<sup>87</sup> The California court’s answer to that question is to assert that state legislatures have the same power that Congress does, to make certain kinds of claims non-arbitrable, either expressly or implicitly by creating a right or remedy having an “inherent conflict” with arbitration.<sup>88</sup>

At first blush, the California court’s reasoning raises eyebrows: after all, the Supremacy Clause makes clear that Congress and state legislatures are not on equal footing when it comes to creating exceptions to a federal statute. But on closer inspection, *Cruz* and *Broughton* are absolutely right. To begin with, as the court is quite correct in pointing out, the U.S. Supreme Court “has never directly decided whether a legislature may restrict a private arbitration agreement when it inherently conflicts with a public statutory purpose that transcends private interests.”<sup>89</sup> All of the FAA preemption cases decided by the U.S. Supreme Court have involved

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86. *Id.* at 1162–63 (quoting *Broughton*, 988 P.2d at 67).

87. *Southland*, 465 U.S. at 10.

88. See *Cruz*, 66 P.3d at 1162–63; *Broughton*, 988 P.2d at 72 (citing *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 225–26 (1987)).

89. *Cruz*, 66 P.3d at 1163 (quoting *Broughton*, 988 P.2d 67, 78–79 (citations omitted)).

private damages claims, not public injunctions. As such, the Court has never had occasion to determine whether broad injunctive relief affecting third parties or the public can be issued by arbitrators. What the Court *has* said, however, is that compelled arbitration of statutory claims is appropriate insofar as the claimant “does not forgo . . . substantive rights . . . .”<sup>90</sup> Absent an express guarantee by the Supreme Court that arbitrators can issue and administer public injunctions, a state court is free to reach the common-sense and highly practical conclusion that arbitrators cannot do so. In such a case, compelling public injunction claims into arbitration would indeed “forgo substantive rights.”

Moreover, *Broughton* and *Cruz* exemplify the best approach of a state court to the federalism issues surrounding FAA preemption. The California court’s correct conclusion that the FAA has not authoritatively been held to encompass public injunction claims is significant, because under the Tenth Amendment to the U.S. Constitution, states retain by default all powers not removed from them, either by constitutional provisions or by statutory preemption under the Supremacy Clause.<sup>91</sup> By refusing to extend the FAA to a new area—public injunction rather than private damages claims—the Court, albeit without explicitly acknowledging this, properly applied the federalism-based presumption against preemption and the doctrine of constitutional avoidance. The presumption against preemption should work against *any* extension of the FAA into a new area, in the absence of a clear statement from Congress of an intent to upset the normal federal-state balance. Here, a state’s power to administer its own dispute resolution system, and allocate certain substantive state claims to specific state remedial and procedural structures, would be undermined by extending FAA preemption. Similarly, this aspect of *Southland*—dictating intrastate dispute resolution mechanisms for state law claims—is the most constitutionally dubious application of FAA preemption. By

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90. *E.g.*, *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)), *quoted in* *Circuit City Stores v. Adams*, 532 U.S. 105, 123 (2001).

91. U.S. CONST. amend. X (“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”).

upholding the authority of the state in this case, the California Supreme Court avoided the constitutional issue—an issue that has never expressly been decided by the U.S. Supreme Court.

## 2. Class Actions

The question of whether a state law preserving a plaintiff's right to pursue class-wide relief is preempted by the FAA was raised, but not decided, by the Supreme Court in *Green Tree Financial Corp. v. Bazzle*.<sup>92</sup> The lower courts continue to struggle with the question of whether the drafting party can use an arbitration agreement to prevent class actions being brought against it. Whether viewed as a question of “arbitrability” or “validity,” the right answer to this question should be “no.”<sup>93</sup> The right to proceed in the form of a class action, aside from promoting state judicial policies in favor of the expeditious resolution of large numbers of disputes, is also a substantial right for the litigant. “The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights.”<sup>94</sup> Adhesive, pre-dispute waivers of class action remedies should be void as against public policy, or unconscionable, just like any substantive waiver of a damages remedy.<sup>95</sup> Alternatively, if class actions are not “arbitrable” under state law, a plaintiff should have the right to proceed in court on a class claim.

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92. 539 U.S. 444, 123 S. Ct. 2402 (2003). For a detailed analysis of that decision, see Schwartz, *Remedy-Stripping*, *supra* note 61.

93. See Schwartz, *Remedy-Stripping*, *supra* note 61.

94. *Amchem Prod. Inc. v. Windsor*, 521 U.S. 591, 617 (1997) (internal quotations omitted).

95. See, e.g., *West Virginia ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 279–80 (W.Va. 2002), *cert. denied*, 537 U.S. 1087 (2002) (predispute waiver of class action unconscionable); *Cruz*, 66 P.3d 1157 (arbitration agreement not enforceable against claim involving remedy designed to protect the public).



### *C. Regulation of Arbitrators*

California has recently enacted ethics rules governing arbitrators and companies that provide arbitration services.<sup>96</sup> Other states could follow suit. Litigation is already beginning to percolate over whether such state regulation of arbitrators is preempted by the FAA.<sup>97</sup>

Clearly, the FAA should not be held to preempt the California law or any reasonable state regulation of arbitrators or arbitration providers. The FAA does not occupy the field of regulating arbitration. Therefore, state arbitrator regulation is not preempted unless it “stands as an obstacle”<sup>98</sup> to the congressional purpose of the FAA, that of making arbitration agreements “as enforceable as other contracts, but not more so.”<sup>99</sup> Arbitrators are in important ways, adjuncts to the state courts, since they often displace the state courts as the official dispute resolution forum.<sup>100</sup> Arbitrators are thus given an important public trust, and arbitration agreements are in this sense like other contracts which create relationships of trust and confidence with professionals—such as attorneys, physicians, financial advisors, and real estate agents. States routinely regulate the licensure and professional standards of such occupations. Allowing regulation and even licensing of arbitrators would treat arbitration agreements like these other contracts, consistent with the FAA’s purpose. Furthermore, the states’ power to regulate arbitrators is an important element of state sovereignty: arbitrator regulation comes within the states’ sovereign interest in controlling their own judicial processes. Finally, since contemporary arbitrators are almost invariably lawyers, the states’ power to regulate arbitrators is closely related to their

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96. See CAL. CODE CIV. P. §§ 1281.92, .96 (2003); Maureen A. Weston, *Re-Examining Arbitral Immunity in an Age of Mandatory and Professional Arbitration*, 88 MINN. L. REV. 449 (2004).

97. See, e.g., *Mayo v. Dean Witter Reynolds, Inc.*, 258 F. Supp. 2d 1097 (N.D. Cal. 2003).

98. See, e.g., *Geier v. Am. Honda Motor Co., Inc.*, 529 U.S. 861, 873 (2000).

99. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967); accord H.R. Res. 96, 68th Cong. (1924) (FAA places arbitration agreements on “same footing as other contracts”); *Volt Info. Scis., Inc. v. Bd. of Trs.*, 489 U.S. 468, 479 (1989) (same).

100. Arbitration is often adjunct to federal litigation as well, but the vast majority of litigation takes place in state courts. See *Parmet*, *supra* note 39, at 58 n.351.

historically sovereign power to regulate the practicing bar.<sup>101</sup> For these reasons, and in light of the presumption against preemption, most state regulation of arbitrators should not be deemed preempted.<sup>102</sup>

### CONCLUSION

It is an open secret that the “national policy favoring arbitration” was not the creation of Congress in enacting the FAA in 1925, but is rather an “edifice of [the Court’s] own creation”<sup>103</sup> starting in the 1980s. There are various policies that might motivate the judicial creation of a pro-arbitration doctrine. The primary motivation is the removal of cases from crowded court dockets and a belief that allowing companies to use private contracts to control disputes with their customers and employees is economically beneficial to society. Whatever might be said for these policies, it is noteworthy that they are never mentioned as justifications in judicial decisions.<sup>104</sup> We know that docket control and deregulation are there as motivations, just as much as we know that the consistent unwillingness of any court to admit those justifications stems from a sense of judicial propriety: they are not proper policies for courts to impose.

Even if federal courts overindulge an impulse to pursue such pro-arbitration policies at the expense of the proper, judicially cognizable value of promoting federalism, the Supremacy Clause does not require state courts to follow suit. Once the conflict between state and federal laws leaves the legislative sphere and enters the courts, the most natural spokespersons for the autonomy and integrity of state contract law are state judges. If they do not serve as federalism guardians against the excessive inroads into state contract law, who will?

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101. *See* *Bates v. State Bar of Arizona*, 433 U.S. 350, 361 (1977) (“[T]he regulation of the activities of the bar is at the core of the State’s power to protect the public.”).

102. Such regulation should be preempted only if it has the purpose or effect of restricting the supply of arbitrators to the point where it is impracticable or impossible for parties to have their claims arbitrated.

103. *Allied-Bruce Terminix Cos. v. Dobson* (1995) (O’Connor, J., concurring).

104. Well, *almost* never. *Cf.* *Sec. Indus. Ass’n v. Connolly*, 883 F.2d 1114, 1116 (1st Cir. 1989) (“[T]he hope has long been that the [FAA] could serve as a therapy for the ailment of the crowded docket.”).

## Appendix A

### Decisions Finding FAA Preemption of State Law,

(January 2002–April 2004)

(partial list)

1.     Stawski Distrib. Co. v. Browary Zywiec S.A., 349 F.3d 1023 (7th Cir. 2003) (FAA preempts Illinois Beer Industry Fair Dealing Act, 815 ILL. COMP. STAT. 720/1–/9 (2004)).

2.     Pedcor Mgmt., Inc. Welfare Benefit Plan v. Nations Pers. of Tex., 343 F.3d 355 (5th Cir. 2003) (FAA preempts Texas judicial policy allowing courts to certify class-wide arbitration).

3.     Stone v. Doerge, 328 F.3d 343 (7th Cir. 2003) (FAA preempts state case law regarding construction of arbitration agreements).

4.     Saturn Distrib. Corp. v. Paramount Saturn, Ltd., 326 F.3d 684 (5th Cir. 2003) (FAA preempts statutory provision for exclusive jurisdiction of Texas Motor Vehicle Board).

5.     Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003) (FAA preempts antiwaiver provision of California Consumer Legal Remedies Act).

6.     Brayman Constr. Corp. v. Home Ins. Co., 319 F.3d 622 (3d Cir. 2003) (FAA preempts state law rule suggesting that statutory tort claims for bad faith insurance practices are not arbitrable).

7.     Arkcom Digital Corp. v. Xerox Corp., 289 F.3d 536 (8th Cir. 2002) (FAA preempts Arkansas Franchise Practices Act, ARK. CODE ANN. §§ 4-72-201 to -210 (2004)).

8.     Aceros Prefabricados, S.A. v. TradeArbed, Inc., 282 F.3d 92, 100 (2d Cir. 2002) (state judicial rule construing arbitration agreements).

9.     Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Coe, 313 F. Supp. 2d 603 (S.D.W. Va. 2004) (FAA preempts state case

law placing “heightened requirements” on enforcement of arbitration clauses).

10. HD Brous & Co., Inc., v. Mrzyglocki, 2004 U.S. Dist. LEXIS 3095 (S.D.N.Y. February 25, 2004) (FAA preempts N.Y. C.P.L.R. 7502 providing that court decides statute of limitations questions in otherwise arbitrable cases).

11. Martin v. SCI Mgmt., 296 F. Supp. 2d 462 (S.D.N.Y. 2003) (FAA preempts New York case law precluding arbitral awards of punitive damages).

12. Pine Ridge Coal Co. v. Loftis, 271 F. Supp. 2d 905 (S.D.W. Va. 2003) (FAA preempts antiwaiver provision in West Virginia workers’ compensation law, W. VA. CODE § 23-2-7 (2003)).

13. Skinner v. Donaldson, Lufkin & Jenrette Secs. Corp., 2003 U.S. Dist. LEXIS 24045 (N.D. Cal. December 29, 2003) (FAA preempts CAL. CODE CIV. P. § 1281.92, setting state standards for review of arbitration awards).

14. M.A. Mortenson/The Meyne Co. v. Edward E. Gillen Co., 2003 U.S. Dist. LEXIS 23175 (D. Minn. December 17, 2003) (FAA preempts Illinois Building and Construction Contract Act, 815 ILL. COMP. STAT. 665/10 (2002), which made contract provisions requiring arbitration in another state unenforceable as against public policy).

15. Newby v. Enron Corp., 2003 U.S. Dist. LEXIS 25038 (S.D. Tex. Dec. 11, 2003) (FAA preempts New York state securities law, the Martin Act, N.Y. GEN. BUS. LAW § 352 (2004)).

16. Greene v. Chase Manhattan Auto. Fin. Corp., 2003 U.S. Dist. LEXIS 21650 (E.D. La. December 2, 2003) (FAA preempts Louisiana Unfair Trade Practices Act, LA. REV. STAT. 51:1401 (2004)).

17. Housh v. Dinovo Invs., Inc., 2003 U.S. Dist. LEXIS 3707 (D. Kan. March 7, 2003) (FAA preempts Kansas arbitration statute precluding tort claims from arbitration, KAN. STAT. ANN. § 5-401(c)).

18. Lomax v. Woodmen of the World Life Ins. Soc’y, 228 F. Supp. 2d 1360, 1365–66 (N.D. Ga. 2002) (FAA preempts Georgia Arbitration Act because the contract was a transaction in interstate commerce and the parties did not specify that Georgia law would apply).

19. *Hawayek v. A.T. Cross Co.*, 221 F. Supp. 2d 254 (D.P.R. 2002) (FAA preempts Puerto Rico Sales Representative Protection Act (Law 21), 10 P.R. LAWS ANN. §§ 279(a)–(h)).

20. *Vigil v. Sears Nat'l Bank*, 205 F. Supp. 2d 566 (E.D. La. 2002) (FAA preempts state decisional law requiring reasonable notice for arbitration clause).

21. *Ruedemann v. Energy Operators, Inc.*, 198 F. Supp. 2d 894 (S.D. Tex. 2002) (FAA preempts TEX. CIV. PRAC. & REM. CODE. §§ 171.001–173.004, barring arbitration of personal injury claims where party's attorney did not sign arbitration agreement).

22. *Lewis Tree Serv. v. Lucent Techs., Inc.*, 239 F. Supp. 2d 332 (S.D.N.Y. 2002) (FAA preempts New Jersey Consumer Fraud Act provisions for class actions and state law claims of breach of implied and express warranties, good faith and fair dealing, breach of contract, and fraud).

23. *Gingiss Int'l, Inc. v. L&H Tuxes, Inc.*, 2002 U.S. Dist. LEXIS 12792 at \*21 n.7 (N.D. Ill. July 15, 2002) (dicta) (FAA likely nullified the California Franchise Act provision voiding out-of-state forum provisions).

24. *Bill Gray Nissan, Inc. v. American Suzuki Motor Corp.*, 2002 U.S. Dist. LEXIS 17297 (W.D. Pa. July 26, 2002) (FAA preempts Pennsylvania Board of Vehicles Act, 63 PA. CONS. STAT. §§ 818.1 through 818.37 (2004)).

25. *Sparks v. Stone St. Capital, Inc.*, 2002 U.S. Dist. LEXIS 11808 (N.D. Tex. June 28, 2002) (FAA preempts Texas General Arbitration Act, TEX. CIV. PRAC. & REM. CODE ANN. §§ 171.002(a)(2) precluding arbitration of claims for acquisition of property less than \$50,000).

26. *Owens v. Coosa Valley Health Care, Inc.*, 2004 Ala. LEXIS 28 (Ala. February 13, 2004) (FAA preempts ALA. CODE § 8-1-41(3) (2004) prohibiting enforcement of predispute arbitration agreements).

27. *Hedges v. Carrigan*, 11 Cal. Rptr. 3d 787 (Cal. Ct. App. 2004) (FAA preempts CAL. CODE CIV. P. § 1298 (2004), setting forth notice requirements for arbitration agreements in real estate contracts).

28. *Ralphs Grocery Co. v. Massie*, 11 Cal. Rptr. 3d 65 (Cal. App. 2004) (FAA preempts CAL. LAB. CODE § 98.7 (2004), state administrative wage and hour proceedings).

29. *Garcia v. DIRECTV, Inc.*, 9 Cal. Rptr. 3d 190 (Cal. App. 2004) (FAA preempts California judicial policy that classwide claims are not arbitrable).

30. *Discover Bank v. Superior Court*, 129 Cal. Rptr. 2d 393 (Cal. App. 2003), *depublished by grant of review*, 65 P.3d 1285 (Cal. 2003) (FAA preempts statutory right to consumer class action proceeding, CAL. CIV. CODE § 1752 (2004)).

31. *Basura v. U.S. Home Corp.*, 120 Cal. Rptr. 2d 328 (Cal. App. 2002) (FAA preempts CAL. CIV. PROC. CODE. § 1298.7 (2004), barring compelled arbitration of personal injury actions under arbitration agreements in construction contracts).

32. *Pitkin v. Fidelity Nat'l Title Ins. Co.*, 2002 Cal. App. Unpub. LEXIS 2610 (March 27, 2002) (FAA preempts state law standard for waiver of right to arbitrate).

33. *Film Finances, Inc., v. Superior Court*, 2002 Cal. App. Unpub. LEXIS 3886 (Cal. Ct. App. February 15, 2002) (FAA preempts CAL. CIV. PROC. CODE. § 1281.2(c) that precluded a party to pending litigation from moving to compel arbitration of case arising from same transaction).

34. *Allen v. Pacheco*, 71 P.3d 375 (Colo. 2003) (FAA preempts standards for enforceability of arbitration agreements for health care under Colorado Health Care Availability Act COLO. REV. STAT. § 13-64-401 (2004)).

35. *District of Columbia v. Greene*, 806 A.2d 216 (D.C. 2002) (FAA preempts District of Columbia Procurement Practices Act, D.C. CODE ANN. § 2-301.01 (2004), requiring procurement disputes with city government to go before administrative review board).

36. *Assuranceföreningen Skuld v. Apollo Ship Chandlers, Inc.*, 847 So. 2d 991 (Fla. Dist. Ct. App. 2003) (FAA preempts judicial policy precluding arbitration of insurance disputes).

37. *Jensen v. Rice*, 809 So. 2d 895 (Fla. Dist. Ct. App. 2002) (FAA preempts Florida case law disfavoring out-of-state forum selection clauses).

38. *Prudential Secs., Inc. v. Katz*, 807 So. 2d 173, 175 (Fla. Dist. Ct. App. 2002) (FAA preemption defeats argument that Florida Whistleblower Act claims not arbitrable).

39. *Heaberlin Farms, Inc. v. IGF Ins. Co.*, 641 N.W.2d 816 (Iowa 2002) (FAA preempts IOWA CODE § 679A.1 (2003), precluding enforcement of adhesive arbitration agreements).

40. *Wolff v. Fidelity Brokerage Servs.*, 15 Mass. L. Rep. 224, 2002 Mass. Super. LEXIS 350 at \*8–\*9 (Mass. Super. Ct. 2002) (FAA preempts state court interpretations that state securities claims not arbitrable).

41. *Abela v. General Motors Corp.*, 669 N.W.2d 271 (2003) (FAA preempts provisions for judicial forum in Michigan's Warranties on New Motor Vehicles Act (Lemon Law), MICH. COMP. LAWS § 257.1401–.1410 (2004) and Michigan's Consumer Protection Act, MICH. COMP. LAWS § 445.901–.922 (2004)).

42. *Le Gere v. New Millenium Homes, Inc.*, 2003 Mich. App. LEXIS 3416 (Mich. Ct. App. December 23, 2003) (FAA preempts MICH. COMP. LAWS § 3.602(B)(2) (2004), Michigan statute providing that court may determine existence of arbitration agreement summarily, without jury trial).

43. *Dunn Indus. Group, Inc. v. City of Sugar Creek*, 2002 Mo. App. LEXIS 2270 (Mo. Ct. App. November 19, 2002), *vacated on other grounds*, 112 S.W.3d 421 (Mo. 2003) (FAA preempts MO. REV. STAT. § 429.330, providing exclusive judicial procedure for equitable mechanic's lien).

44. *Cornhusker Int'l Trucks, Inc. v. Thomas Built Buses, Inc.*, 637 N.W.2d 876 (Neb. 2002) (FAA preempts NEB. REV. STAT. § 60-1420 (2000), providing exclusive remedy for motor vehicle dealership franchise disputes).

45. *Utica Mut. Ins. Co. v. Gulf Ins. Co.*, 306 A.D.2d 877 (N.Y. App. Div. 2003) (FAA preempts New York state arbitration law).

46. *Boynton v. ESC Med. Sys.*, 566 S.E.2d 730 (N.C. App. 2002) (FAA preempts N.C. GEN. STAT. § 22B-3 (2004), invalidating out-of-state forum selection clauses).

47. *Rich v. Walsh*, 590 S.E.2d 506 (S.C. Ct. App. 2003) (FAA preempts South Carolina Uniform Arbitration Act).

48. *Blanton v. Stathos*, 570 S.E.2d 565 (S.C. Ct. App. 2002) (FAA preempts S.C. CODE ANN. § 15-48-10(a) (2004), imposing certain form requirements on arbitration agreements).

49. *Smith v. Gateway, Inc.*, 2002 Tex. App. LEXIS 5438 (July 26, 2002) (FAA preempts non-waiver provisions of the Deceptive Trade Practices-Consumer Protection Act, TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (2002)).



## APPENDIX B

## STATE LAWS CONTAINING GENERIC ANTIWAIVER PROVISIONS

(partial list)

1. ALA. CODE § 8-6-19(h) (2002) (civil remedies for violations of Alabama Blue Sky laws).
2. ALASKA STAT. § 34.55.030(g) (2002) (statutory rights in connection with the purchase of subdivided land).
3. ARIZ. REV. STAT. § 44-1560 (2003) (statutory rights under Petroleum Products laws).
4. ARK. CODE ANN. § 23-42-109 (2000) (rights under Arkansas Blue Sky laws).
5. CAL BUS. & PROF. CODE § 20010 (2004) (rights under the California franchise investment laws).
6. COLO. REV. STAT. § 11-51-604(11) (2003) (rights provided under the Colorado Blue Sky laws).
7. CONN. GEN. STAT. § 47-90a(f) (2004) (rights under the Connecticut Condominium Act, including remedies for misrepresentations in public offering statements).
8. DEL. CODE ANN. tit. 6 § 7323(g) (1999) (rights under Delaware Blue Sky Laws).
9. FLA. STAT. ANN. § 501.615(9) (2002) (rights under Florida Telephone Solicitation Act in connection with telemarketing transactions).
10. HAW. REV. STAT. § 482E-6(2)(F) (2002) (rights under Hawaii franchise laws).
11. IDAHO CODE § 30-1446(4) (1999) (rights under Idaho Blue Sky Laws).
12. 815 ILL. COMP. STAT. 705/41 (rights under the Illinois Franchise Disclosure Act), <http://www.legis.state.il.us/legislation/ilcs/ilcs.asp> (last visited August 2, 2004).
13. IND. CODE ANN. § 24-4.5-1-107(1) (West 2004) (rights under consumer protection laws in consumer credit transactions).
14. IOWA CODE ANN. § 537.1107 (2003) (rights under the Iowa Consumer Credit Code).

15. KAN. STAT. ANN. § 58-3316(g) (2003) (rights, including civil remedies, under Kansas laws relating to purchase of subdivided lands).

16. KY. REV. STAT. § 367.460 (1994) (rights of buyers in home solicitation transactions).

17. ME. CONSUMER CREDIT CODE, tit. 9-A § 1-107(1) (2004).

18. MD. CORPS. & ASS'N. CODE § 11-703(h) (2004) (rights under Maryland Blue Sky Laws).

19. MASS. GEN. LAWS ANN. ch. 110A, § 410(g) (2002) (rights under Massachusetts Blue Sky Laws).

20. MICH. COMP. LAWS ANN. § 125.2332 (West 1997) (rights under Michigan Resort District Rehabilitation Act).

21. MINN. STAT. § 82A.23 (1999) (rights accorded under Minnesota law relating to the purchase of membership camping contracts).

22. NEB. REV. STAT. § 8-1721.01(3) (1997) (rights for a purchaser under the Nebraska Commodity Code).

23. N.Y. GEN. BUS. LAW § 687(4) (2004) (rights under the New York Franchise Act).

24. OHIO REV. CODE ANN. § 1345.49 (West 2003) (rights of consumers under Ohio Uniform Commercial Code with respect to “prepaid entertainment contracts” such as dance studio contracts or health spa services).

25. OKLA. STAT. tit. 14A § 1-107(1) (1996) (rights under the Oklahoma Consumer Credit Code).

26. 73 PA. CONS. STAT. ANN. § 2189(a) (West 1993) (rights under the Pennsylvania Credit Services Act)

27. S.C. CODE ANN. § 37-1-107(1) (West 2002) (rights under the South Carolina Consumer Protection Code).

28. TENN. CODE ANN. § 48-2-122(I) (2002) (rights under the Tennessee Blue Sky Laws).

29. TEX. BUS. & COMM. CODE § 17.42 (2004) (rights under Deceptive Trade Practices-Consumer Protection Act).

30. WIS. STAT. § 421.106(1) (1998) (rights under the Wisconsin Consumer Act).